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Endowment Fund Annual Report

University Of Maine System

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University of Maine System Annual Endowment Report June 30, 2008

The Endowment funds of the University of Maine System are subject to the restrictions of gift instruments requiring that the principal be invested and current expenditures be funded from related income and appreciation.

Management

The following people meet quarterly to provide oversight of the Endowment and to make portfolio management and investment management decisions for the fund:

- Board of Trustees Investment Committee
- Investment Consultant – New England Pension Consultants (NEPC) – Cambridge, MA
- Joanne Yestramski – CFO & Treasurer, UMS
- Tracy Elliott – Director of Finance & Controller, UMS
- Peter Small – Institutional Research Analyst, UMS

Governing Guidelines

Formal guidelines govern the Endowment Investment Process. The guidelines include:

- Total return and risk objectives
- Third party investor criteria
- Statement of goals and objectives
- Investment guidelines
 - Asset allocation target percentages, permissible ranges, and evaluation benchmarks
 - Use of hedge funds
 - Permitted and excluded investments
 - Use of derivatives
 - Spending policy
- Performance standards and evaluation
- Responsibilities of all parties concerned
- Conflict of interest

The guidelines established by the Investment Committee target a minimum long term return objective of 8.5%.

FY 2008 Performance

FY08 was a tough year for the market. The Endowment fund had a net of fees annual return of -2.6%, *placing it in the top 26th percentile* (i.e., exceeding 74%) *of the total fund universe* tracked by the System's investment consultant. This return compares to an S&P 500 return of -13.1%, and a Lehman Brothers Aggregate return of 7.1%. The plan assets totaled \$115 million, a decrease of \$8 million over the prior year-end balance.

The plan's 5-year annualized return of 10.4% ranks in the top 15% of all funds, while the risk-adjusted performance puts the fund in the top 14%. This return compares to an S&P 500 return of 7.6% and a Lehman Brothers Aggregate return of 3.9% over the 5-year period.

Changes in Asset Managers

To further diversify the portfolio, in October 2007, the Investment Committee approved the addition of two fund managers: Gottex Fund Management and Permal Group, both of which are Hedge Fund of Fund strategies. The mandates were funded during the January to April of 2008 timeframe by rebalancing the portfolio and eliminating the allocation to the T. Rowe Price High Yield Fund.

Specifically, the endowment pool invested in the Gottex Market Neutral Plus Fund strategy which strives to generate consistent absolute returns over the medium term with low correlation to major stock and fixed-income market indices. The underlying hedge fund managers within the portfolio primarily pursue market neutral implementations of strategies that fall within the relative value, event driven and hedged equities styles.

In addition, the Permal Fixed Income Holdings Institutional fund is a diversified Hedge Fund of Funds portfolio with 2 sub-allocations: credit spread and non-credit spread related strategies. The fund's manager employs a dynamic asset allocation process that shifts capital between these 2 strategies depending on their views on the markets. The Fund targets a performance of LIBOR + 3% over a full cycle.

In June 2008, a new global asset manager, Wellington Management Company, was approved by the Investment Committee. The Wellington Opportunistic Investment Fund was funded during the July to September 2008 timeframe by rebalancing the portfolio. The fund seeks to outperform 65% S&P/ 35% LB Aggregate by providing opportunistic exposure to a variety of non-core investment areas and new product ideas. Wellington actively rotates to asset classes as opportunities change.

Diversification

The Endowment fund is well diversified by style, asset class, and geography. The fund is diversified among 9 different asset classes and is managed by 14 different investment managers. The large size of the fund permits fuller diversification (which enhances risk adjusted returns) as well as access to attractive asset classes/managers. Additionally, larger investments benefit from reduced investment manager, consultant and custodial fees.

As of June 30, 2008, about 40% (\$46.1 million) of the fund was invested in **Domestic Equities**, which is further segmented into Passively Managed, Large Cap, and Small/Mid Cap investment categories. Within the Large Cap and Small/Mid Cap categories, the investments are further diversified into growth and value styles.

Roughly 15% (\$17.4 million) of the fund is invested in **international developed and emerging market stocks**, to provide diversification benefits and to pursue attractive equity investment opportunities worldwide.

Approximately 13% (\$15.1 million) of the assets were invested in **fixed income** strategies with a Global Multi-Strategy Bond fund (invests in the most attractive fixed income sectors worldwide) and less than 1% in cash.

Almost 9% (\$10.0 million) of the assets were invested in a **global absolute return** strategy which seeks to invest in those asset classes worldwide which offer the best relative value.

About 23% (\$26.3 million) of the fund was invested in **alternative strategies**, with 7.6% in **market neutral** investments (to improve stability of return), 10.4% in **hedge funds** (which seek consistent, absolute returns, with little correlation to traditional assets), and 4.9% in **timber** (which provides greater diversification as historically timberland has been negatively correlated with traditional assets).

Endowment Fund Inflows and Outflows – FY08

The following endowment fund information is provided for fiscal year ending June 30, 2008 and includes all pool assets (i.e., assets of the UMS and amounts held for others¹).

	(Unaudited) (000's)
Total Endowment at Market Value - June 30, 2008	<u>\$115,181</u>
Total Endowment at Market Value - June 30, 2007	<u>\$123,014</u>
The FY08 decrease of \$7,833 is comprised of:	
Inflows (Outflows):	
Gifts (UMS and UMS affiliated organizations)	\$783
Return to Principal	53
Charitable Gift Annuities (Net of Annuitant Payments)	103
Transfers	(38)
Investment Returns:	
Income	5,090
Net Appreciation (Depreciation)	(7,403)
Fees/Expenses	<u>(974)</u>
4.7% Distribution for Scholarships & Operations	(5,434)
Endowment Forwarded to Foundations at Donors' Request	<u>(13)</u>
Net Inflows and Outflows:	<u>(7,833)</u>

Returns, Historical Growth, and Allocation

¹ The University of Maine at Farmington Alumni Foundation, the University of Maine at Fort Kent Foundation, the University of Southern Maine Foundation, and the John L. Martin Scholarship Fund, Inc. participate in the UMS endowment pool through a management agreement. The fair values of these investments at June 30, 2008 and 2007, are \$10.8 million (unaudited) and \$11.6 million, respectively.

Attachment I reports the total returns for the Pooled Endowment fund on a net of fees basis and the fund's growth for the past 5 years, as well as the asset allocation for the fiscal years ended June 30, 2007 and 2008.

Endowment Distribution

The distribution amount is determined using a 2 part formula:

- Part 1 considers the current FY endowment distribution amount increased by the consumer price index
- Part 2 considers the current endowment fund market value multiplied by a 5% spending rate.

The resulting distribution rate equates to approximately 4.7% for FY08. This rate is subject to specific spending requirements in gift instruments.

UNIVERSITY OF MAINE SYSTEM

POOLED ENDOWMENT FUND

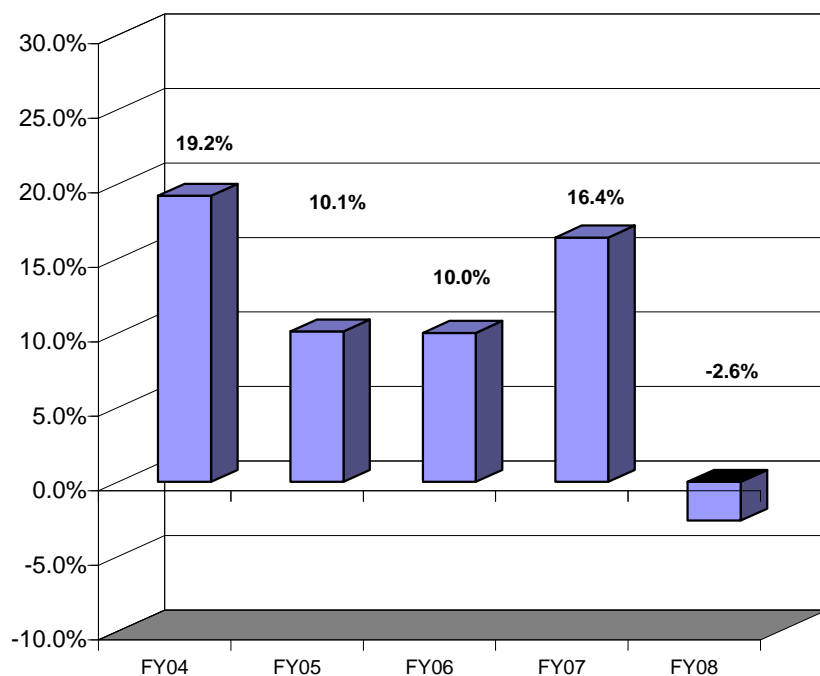
AS OF JUNE 30, 2008

This attachment presents the University of Maine System's Pooled Endowment Fund asset allocation for fiscal years ended June 30, 2007 and 2008, total return figures net of fees, and growth of the Endowment since FY04

Market Value and Allocation of Pooled Endowment (000's)

	June 30, 2007		June 30, 2008	
Domestic Equities	\$ 53,283	46%	\$ 46,133	40%
Int'l Equities	24,756	21%	17,391	15%
Multi Strategy Bond	18,222	16%	15,039	13%
High Yield Bond	4,352	4%	-	0%
Market Neutral	7,253	6%	8,689	8%
Global Absol. Return	9,915	9%	10,016	9%
Hedge Funds	-	0%	11,994	10%
Timber	4,145	4%	5,666	5%
Cash	978	1%	254	0%
Total	\$ 122,904	107%	\$ 115,182	100%

Endowment Fund Total Returns (Net of Fees)



Endowment Fund Market Values (\$ in millions)

